

Drought Economics

Glenn Nader – UC Livestock and Natural Resources Advisor

ganader@ucanr.edu

There are many considerations that need to be thought through to develop a drought plan that makes sense for your ranch. How many cows do you want to try to keep? There are values to keeping a core herd (genetics, diseases (foohill and anaplaz immunity), and cattle's knowledge of range they graze). All of these attributes have real costs when rebuilding a herd. Two dollar a pound calves right now does not mean high prices in June or when ever you sell. Conservatively budget for calf prices and feed costs. As you reduce herd numbers, how will fixed costs be covered? Some have used the equity from additional cow sales to cover those costs. But then, how do you rebuild the herd after the drought ends?

Planning

Planning through a drought is difficult, as there are only long range weather forecasts to base assumptions on. Most ranchers break it by season. If only 20% of winter feed is available, 80% of summer and no dry feed in the valley range until next late March or April, what steps are needed?

Three major items that need to be considered are:

- Estimating duration of the drought
- Current feed resources and needed supplementation
- Financial resources

Possible Actions

I have put these in the order that I would consider each action, depending on the impact of the drought on the ranch.

1. Early Weaning

The first action to consider is early weaning of calves. This will save the cow's body condition and will reduce feed consumption. Both of these have long term savings. The calves can be sold or confined and put on a higher plain of nutrition that will increase their gains. Lactating cow's demands increases their protein requirement by 100% and energy by 60%. Most producers wean 30 to 90 days early. For more information on early weaning calves go to http://aces.nmsu.edu/drought/documents/evaluating-early-weaning_6_6_13.pdf

2. Sell cattle that will have delayed income

Replacement heifers and open cows will take up feed without producing any income for over next year. This action will keep animals that will provide returns to address the increased feed costs.

3. Sell cattle that have a higher feed costs to maintain body condition

Cull low body condition score and broken mouth cows. With additional drought feed costs, these cattle will require better nutrition to breed and lactate for a calf. Also, by keeping younger cows, there is a longer lifespan to recoup the additional feed costs.

Dealing with the Feed Deficient

In limited droughts, purchase of hay to supplement on range can be implemented. Discussion on feeding options occurs in the publication "Use of Alternative feedstuffs in Your Beef Operation". Looking for additional grazing pastures will be limited locally and trucking outside the drought area would require the increased cost of transportation and care at that location, but could be cheaper than feeding on your ranch. Confinement lot feeding of cattle requires the purchase of feeding facilities and equipment. Some have placed breeding cattle in feedlots for short term solutions.

Feeding corn at its present price can reduce the costs and spare the limited forage available during a drought. For more information go to http://www.okstate.edu/OSU_Ag/oces/timely/feeding.htm

Drought Risk Management

Purchase of government or private drought insurance is a very prudent action. The government process has its limits, which are illustrated by the present lack of passage of a farm bill that prevents feed program payments. Comparing costs and risks between private and government insurance for the next season should be considered.

Taxes are Crucial

Sales of animals due to reduced feed caused by a drought will present potentially large tax liabilities. It is important to maintain as much of the equity from these sales to rebuild the herd after the drought. There are two provisions in the tax code that address the ability of livestock owners to exercise deferment of taxes.

Code Section 451(e)

Allows ranchers whose principal business is agriculture and who use a cash accounting method to postpone reporting the taxable gain on sales of any livestock above the yearly average sales for one year. To qualify, the producer's county must have received a federal disaster declaration. Sales related to the drought under this section can qualify even if they occur prior to the declaration.

Code Section 1033(e)

Allows ranchers whose principal business is agriculture and who use any accounting method to postpone, and altogether avoid, paying taxes on the gain from the sale of breeding animals above the yearly average sales, if they are replaced within a specified time frame. The time frame varies depending on whether or not your county was declared a federal drought disaster. In federally declared drought counties, the replacement period ends at the conclusion of the first taxable year after the first drought-free year for that county. The "first drought-free year" is determined based upon the US Drought Monitor at <http://www.drought.unl.edu/dm/monitor.html>. IRS will publish a list each September of the counties for which a drought exists. In counties not declared federal disaster area the replacement period ends two years after the close of the tax year in which the involuntary sales occurred.

For more information go:

National Cattlemen's Beef Association, 2011, Q&A: Tax Options for Drought Sales of Livestock, National Cattlemen's Beef Association, Washington, D.C. 20004, (202)347 - 0228

<http://www.beefusa.org/uDocs/qaondroughttaxmay07.pdf>

JC Hobbs. 2010. Weather Related Sales of Livestock. Oklahoma State Univ.

[http://ruraltax.org/files/uploads/Livestock%20Sales%20\(RTE%202010-09\).pdf](http://ruraltax.org/files/uploads/Livestock%20Sales%20(RTE%202010-09).pdf)

The information in this article is a guide to help you examine the management options available to you. To ensure that you qualify for tax relief under either of these code sections it is advisable to speak with a tax professional.

Realize that if you sell when pairs are \$1600 that you may be forced to buy back in at \$3000/pair when the drought ends to prevent paying capital gains taxes. That will require either: having other equity to reinvest, getting a loan, or building back slowly.

Focused Considerations

Feed costs are the main management focus during a drought. Evaluating different rations to determine the least cost feed solutions to maintain body conditions and allow for breeding and lactation to raise a calf crop for the next year is very important.

The drought question will be how much additional spending on feed can be sustained. That will depend on many factors including calf prices at the time of sale, what the breeding pairs will be at the end of the drought, and cash flow available.

Keeping your lender informed of your plans and how you will meet the cash flow requirements is an important action.

Budgeting

To assist you in developing a budget, University of California Cooperative Extension has a cow/calf budget template that can be found on the web at SFREC website.